Report

of the

Examination of

Hamburg-Stark Mutual Insurance Company

Coon Valley, Wisconsin

As of December 31, 2002

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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August 25, 2003

Honorable Jorge Gomez
Commissioner of Insurance
State of Wisconsin
125 South Webster Street
Madison, Wisconsin 53702

Commissioner:

In accordance with your instructions, an examination has been performed as of December 31, 2002, of the affairs and financial condition of

HAMBURG STARK MUTUAL INSURANCE COMPANY
COON VALLEY, WISCONSIN

and the following report thereon is respectfully submitted:

I. INTRODUCTION

The last examination of this company was made in 1999 as of December 31, 1998. The current examination covered the intervening time period ending December 31, 2002, and included a review of such subsequent transactions deemed essential to complete this examination.

The Summary of Examination Results contains elaboration on all areas of the company's operations. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The company was originally organized as a town mutual insurance company on January 19, 1867, under the provisions of the then existing Wisconsin Statutes. The original name of the company was the Vernon County Scandinavian Mutual Insurance Company. Subsequent amendments to the company's articles and bylaws changed the company's name to Hamburg Mutual Insurance Company. Effective September 30, 1991, Hamburg Mutual Insurance

Company merged with Stark Mutual Town Insurance Company, with Hamburg being the surviving company. The articles of incorporation and bylaws were amended to reflect the terms of the merger and to change the name to that presently used.

During the period under examination, there were no amendments to the articles of incorporation or the bylaws.

A review of the certificate of authority revealed that the company is currently licensed to write business in the following counties:

> Crawford, Grant, Jackson, Juneau, La Crosse, Monroe, Richland, Sauk, and Vernon

The company is currently licensed to write property, including windstorm and hail, and nonproperty insurance.

A review was made of the policy and application forms currently used by the company. The company issues an approved policy with or without endorsements for a term of one year with premiums payable on the advance premium basis. Policy fees charged to policyholders are retained by the company.

Business of the company is acquired through 45 agents, five of whom are directors of the company. Agents are presently compensated for their services as follows:

Type of Policy	**Compensation**
All policies	15% of gross premiums written

Agents have authority to adjust losses up to $1,500 not involving liability claims, subrogation, betterment, or depreciation. Losses in excess of $1,500 are adjusted by the company's full time adjuster/inspector or an outside adjuster depending on the situation. Agents receive $10.00 per hour for each loss adjusted with no mileage reimbursement. The company's full time adjuster/inspector receives an annual salary of $32,000 plus $0.365 a mile for travel reimbursement. Outside adjusters receive between $42.00 and $52.00 per hour for each loss adjusted plus reimbursement for any expenses associated with adjustment of the loss.

Policyholders may participate in the management and control of the company by attending and voting at all annual or special meetings of the members. No member may vote by proxy. The annual meeting of the company for the election of directors and special meetings of the company are held in accordance with its articles of incorporation.

Board of Directors

The board of directors consists of nine members divided into three classes. One class is elected at each annual meeting for a term of three years. Vacancies on the board may be filled by the directors for the interim to the next annual meeting when a director shall be chosen for the unexpired term.

The current board of directors consists of the following policyholders of the company:

Name	Principal Occupation	Residence	Expiry
Gary Ascher *****	Insurance Agent	Viroqua	2003
Mike Lium *****	Insurance Agent	Westby	2003
Margaret Lee *****	Insurance Agent	LaFarge	2003
Dean Dregne *****	Insurance Agent	Viroqua	2004
Melvin DeWitt	Grocery Store Owner	Yuba	2004
Curt Brye	Loan Officer	Coon Valley	2004
Paul Larsen	Sr. Vice President of Bank	Viroqua	2005
Chris Hanson *****	Insurance Agent/Dairy Farmer	Chaseburg	2005
Paul Buhr	Dairy Farmer	Viroqua	2005

***** Directors who are also agents are identified with an asterisk.

Members of the board currently receive $100.00 for each meeting attended and $0.365 per mile for travel expenses.

Officers

Officers are elected by the board of directors from among its members and hold office for one year or until their successors are duly elected and qualified.

Officers serving at the present time are as follows:

Name	Office	2002 Salary
Mike Lium	President	$2,250
Gary Ascher	Vice President	1,000
Margaret Lee	Secretary/Treasurer	2,250
William Ellingson	Chief Executive Officer	62,000

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. The committees at the time of the examination are listed below:

Adjusting Committee
Dean Dregne, Chair
Chris Hanson
Paul Buhr
Melvin DeWitt

Finance Committee
Mike Lium, Chair
Curt Brye
Paul Larsen
Gary Ascher

Executive Committee
Mike Lium, Chair
Gary Ascher
Margaret Lee
William Ellingson

Growth of Company

The growth of the company during the past five years as compiled from its filed annual statements was as follows:

Year	Net Premiums Earned	Net Losses and LAE Incurred	Policies In Force	Net Income	Admitted Assets	Policyholders' Surplus
2002	$1,593,948	$894,075	3,710	$62,400	$2,378,642	$860,975
2001	1,171,061	1,005,723	3,526	(292,813)	1,867,079	899,215
2000	1,029,755	842,760	3,674	(104,656)	2,218,666	1,201,511
1999	1,052,082	827,898	3,608	(35,044)	2,368,069	1,229,792
1998	958,265	905,135	3,499	(312,578)	2,306,700	1,329,811

The ratios of premiums written, gross and net, to surplus as regards policyholders during the past five years were as follows:

Year	Gross Premiums Written	Net Premiums Written	Ending Surplus	Writings Gross	Ratios Net
2002	$2,344,833	$1,909,333	$860,975	272%	222%
2001	2,081,173	1,235,595	899,215	231	137
2000	1,889,526	1,083,500	1,201,511	157	90
1999	1,800,334	905,562	1,229,792	146	74
1998	1,651,686	1,121,669	1,329,811	124	84

For the same period, the company's operating ratios were as follows:

Year	Net Losses and LAE Incurred	Other Underwriting Expenses Incurred	Net Earned Premiums	Loss Ratio	Expense Ratio	Composite Ratio
2002	$894,075	$671,847	$1,593,948	56%	42%	98%
2001	1,005,723	504,444	1,171,061	86	43	129
2000	842,760	387,919	1,029,755	82	38	120
1999	827,898	339,158	1,052,082	79	32	111
1998	905,135	448,124	958,265	94	43	137

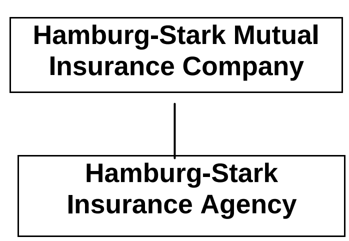
The company has reported composite ratios of well over 110% in the period beginning in 1998 through 2001. Its composite ratio has been higher than the town mutual industry average of 119% over that same period of time. The company also reported underwriting losses in ten of the past eleven years resulting in an average annual underwriting loss of $171,446.00. The incurred loss and LAE ratio has averaged 79% over the period covered under this examination. There have been net losses reported four times over this same period, with the largest ($312,578) occurring in 1998. Gross premiums written increased 42% over the five year-period from 1998 to 2002 and net premiums written increased by 70% due to a change in the company's reinsurance program. The company elected to retain more premiums and thereby more underwriting risk. Policyholders' surplus decreased 35% over the last five years and has been declining for six consecutive years.

The continued increase in the ratio of premiums written to surplus is a result of the deteriorating surplus, a change to the company's reinsurance program whereby it retains more premiums and a steady increase in premium volume that resulted from both an increase in rates and policies in force. The ratio of premiums written to surplus increased from 84% in 1998 to 222% in 2002. The ratio of premium written is a measure of the risk the company has undertaken compared to its resources available to absorb any losses. The current premium to surplus ratio is about 5 times greater than the town mutual industry average of 43% and at a level where company management and its board of directors should be concerned about the company's financial health. The company has also asked permission to expand its territory to write in three more Wisconsin counties.

Affiliated Companies

Hamburg-Stark Mutual Insurance Company is a member and the ultimate parent of a holding company system. The organizational chart below depicts the relationship among the affiliates in the group. A brief description of the affiliate follows the organizational chart.

Holding Company Chart
As of December 31, 2002



Hamburg-Stark Insurance Agency

Hamburg-Stark Insurance Agency was created by Hamburg-Stark Mutual Insurance Company to provide an avenue by which its agents could write personal umbrella insurance policies through the company's previous reinsurer. The agency was initially capitalized at $5,000 with Hamburg-Stark Mutual Insurance Company holding 100% of the outstanding shares.

At the time of the examination, the agency was not transacting any business. As of December 31, 2002, the company's unaudited financial statement reported assets of $259, no liabilities, and equity of $259. Since the company was not actively doing business in 2002, it did not produce income.

Hamburg-Stark Mutual Insurance Company provides all of the administrative and management services necessary for Hamburg-Stark Insurance Agency. There is a services agreement between the company and the agency. However, no expenses were allocated to the agency during the last two years due to its inactivity. The company's board of directors has decided to keep the legal structure of Hamburg-Stark Insurance Agency in place in case it is needed in the future.

II. REINSURANCE

The examiners' review of the company's reinsurance portfolio revealed that there is currently one ceding treaty. The treaty contained a proper insolvency clause and complied with s. Ins 13.09 (3), Wis. Adm. Code, concerning maximum wind loss. Company retentions of risk complied with s. Ins 13.06, Wis. Adm. Code.

Reinsurer:	Wisconsin Reinsurance Corporation
Effective date:	January 1, 2003, continuous
Termination provisions:	By either party, on any January 1, with 90 days' advanced written notice.

The coverage provided under this treaty is summarized as follows:

1.	Type of contract:	Excess of Loss (Class A)
	Lines reinsured:	Liability (nonproperty)
	Company's retention:	$10,000 for each and every loss occurrence
	Coverage:	100% in excess of retention including loss adjusting expense, subject to policy limits of $1,000,000 for bodily injury and property damage, and $5,000 per person and $25,000 per accident for medical payments.
	Reinsurance premium:	40% of gross liability premiums charged for each policy issued, which are consistent with the scheduled liability reinsurance rates
2.	Type of contract:	First Surplus (Class B)
	Lines reinsured:	All property business
	Company's retention:	When the company's net retention is $300,000 or more, the company may cede on a pro rata basis up to $800,000. When net retention is less than $300,000, the company may cede on a pro rata basis up to 50% of such risk.
	Coverage:	Pro rata portion of each loss and LAE up to $800,000 above retention.
	Reinsurance premium:	Pro rata portion of premium and fees on each risk ceded
	Ceding commission:	Provisional commission of 15%, with a minimum of 15% and maximum of 35% based on the loss ratio

3.	Type of contract:	Excess of Loss (Class C-1)
	Lines reinsured:	All property business written
	Company's retention:	$100,000 on each and every risk and per occurrence
	Coverage:	$100,000 each and every risk and loss occurrence, including loss adjusting expense, above retention
	Reinsurance premium:	Rate based on net premium written and losses incurred for immediate preceding four years, subject to a minimum rate of 3% and a maximum rate of 23.5% of current net premium written. The 2003 annual rate is 3% with a deposit premium of $56,700.
	Termination premium:	If contract is canceled, final rate based on net premium written and losses incurred for immediate preceding four years plus the current year's net premium written and losses incurred.
4.	Type of contract:	Second Excess of Loss (Class C-2)
	Lines reinsured:	All property business written
	Company's retention:	$200,000 on each and every risk and per occurrence
	Coverage:	$100,000 each and every risk and loss occurrence, including loss adjusting expense, above retention
	Reinsurance premium:	1.5% of net premiums written for business covered subject to minimum premium of $22,500 and deposit premium of $28,200
5.	Type of contract:	First Aggregate Stop Loss & Catastrophe (Class D/E)
	Lines reinsured:	All business written
		Part A – Catastrophe Coverage
	Company's retention:	$200,000 from each loss occurrence
	Coverage:	100% of aggregate losses, including loss adjustment expenses, in the annual period that exceed the retention, but not to exceed $250,000 for any one loss occurrence and not to exceed $500,000 for each annual period.
		Part B – Stop Loss Coverage
	Company's retention:	Losses in aggregate equal to 70% of the net premiums written, subject to a minimum retention of $1,210,000 for the year
	Coverage:	100% of aggregate losses, including loss adjustment expenses, in the annual period that exceed the retention

Reinsurance premium:	Rate based on the losses and premiums ceded under the D/E coverage during the previous eight years times 125%, subject to a minimum rate of 7.5% and a maximum of 25%. The 2003 annual rate is 10.5% with a deposit premium of $226,800.

III. FINANCIAL DATA

The following financial statements were filed with the Commissioner of Insurance in the company's annual statement at December 31, 2002. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Policyholders' Surplus."

Hamburg-Stark Mutual Insurance Company
Statement of Assets and Liabilities
As of December 31, 2002

Assets	Ledger	Nonledger	Not Admitted	Net Admitted
Cash in Company's Office	$ 100	$	$	$ 100
Cash Deposited in Checking Account	89,276			89,276
Cash Deposited at Interest	349,762			349,762
Bonds (at Amortized Cost)	902,950			902,950
Stocks or Mutual Fund Investments (at Market)	417,671			417,671
Real Estate	98,165			98,165
Premiums and Agents' Balances and Installments:				
In Course of Collection	137,456			137,456
Deferred and Not Yet Due	331,044			331,044
Investment Income Accrued		15,277		15,277
Reinsurance Recoverable on Paid Losses and LAE	24,033			24,033
Electronic Data Processing Equipment	12,908			12,908
Furniture and Fixtures	2,107		2,107	
Other Nonadmitted Assets:				
Computer Software	21,979		21,979	
TOTALS	$ 2,387,451	$ 15,277	$ 24,086	$ 2,378,642

Hamburg-Stark Mutual Insurance Company
Statement of Assets and Liabilities (cont.)
As of December 31, 2002

Liabilities and Surplus

Net Unpaid Losses	$ 190,233
Unpaid Loss Adjustment Expenses	4,000
Commissions Payable	104,843
Fire Department Dues Payable	3,928
Unearned Premiums	1,033,073
Reinsurance Payable	141,374
Other Liabilities:	
Expense Related:	
Accounts Payable	3,449
Accrued Property Tax	4,179
Nonexpense Related:	
Premiums Received in Advance	32,588
TOTAL LIABILITIES	1,517,667
Policyholders' Surplus	860,975
TOTAL	$2,378,642

Hamburg-Stark Mutual Insurance Company
Statement of Operations
For the Year 2002

Net Premiums and Assessments Earned		$1,593,948
Deduct:		
Net Losses Incurred	837,855	
Net Loss Adjustment Expenses Incurred	56,220	
Other Underwriting Expenses Incurred	671,847	
Total Losses and Expenses Incurred		1,565,922
Net Underwriting Gain (Loss)		28,026
Net Investment Income:		
Net Investment Income Earned	20,849	
Net Realized Capital Gains	3,844	
Total Investment Income		24,693
Other Income:		
Miscellaneous Income	9,681	
Total Other Income		9,681
Net Income (Loss) Before Policyholder Dividends and Before Federal Income Taxes		62,400
Policyholder Refunds or Dividends		0
Net Income (Loss) Before Federal Income Taxes		62,400
Federal Income Taxes Incurred		0
Net Income (Loss)		$ 62,400

Hamburg-Stark Mutual Insurance Company
Reconciliation and Analysis of Surplus as Regards Policyholders
For the Five-Year Period Ending December 31, 2002

The following schedule is a reconciliation of surplus as regards policyholders during the period under examination as reported by the company in its filed annual statements:

	2002	2001	2000	1999	1998
Surplus, beginning of year	$899,215	$1,201,511	$1,229,792	$1,329,811	$1,573,366
Net income	62,400	(292,813)	(104,656)	(35,044)	(312,578)
Net unrealized capital gains or (losses)	(79,926)	(10,539)	80,089	(68,230)	65,309
Change in non-admitted assets	(20,714)	1,056	(3,714)	3,255	3,714
Surplus, end of year	$860,975	$899,215	$1,201,511	$1,229,811	$1,329,911

Reconciliation of Policyholders' Surplus

A reconciliation of the policyholders' surplus as reported by the company in its filed annual statement and as determined by the examination is detailed in the following schedule:

Policyholders' Surplus per December 31, 2002, Annual Statement			$860,975
Item	**Increase**	**Decrease**	
Unpaid Loss Adjustment Expense	$	$11,297	
Accounts Payable		$ 2,122	
Total	$	$13,419	
Decrease to Surplus per Examination			(13,419)
Policyholders' Surplus per Examination			$847,556

IV. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

Comments and recommendations contained in the last examination report and the action taken on them by the company are as follows:

1. Corporate Records—It is recommended that the company require directors to file signed conflict of interest questionnaires with the company yearly and that all potential conflicts be disclosed in compliance with the directive of the Commissioner.

   Action—Noncompliance, additional comment on this area is contained in the Current Examination Results section of this report.

2. Underwriting—It is again recommended that the company establish a formal inspection procedure for new and renewal business, whereby a sampling of new applications and of renewal business is inspected by committee members independent of the risk under consideration.

   Action—Compliance

3. Claims Adjusting—It is recommended that the company keep minutes of the claims committee's meetings to provide evidence that it is performing its duty to supervise the adjustment of losses as required by s. 612.13 (4), Wis. Stat. and that the board of directors review the actions of the claims committee on a regular basis

   Action—Partial compliance, additional comment on this area is contained in the Current Examination Results section of this report.

4. Disaster Recovery Plan—It is recommended that the company develop a disaster recovery plan.

   Action—Noncompliance, additional comment on this area is contained in the Current Examination Results section of this report.

5. Transition Into New Investment Rule—It is recommended that the company make no additional Type 2 investments until the company meets the required amount of Type 1 investments, pursuant to s. Ins 6.20 (6) (c), Wis. Adm. Code

   Action—Compliance

6. Transition Into New Investment Rule—It is recommended that the company report bonds with a final maturity of more than 15 years as Type 2 on the annual statement in accordance with s. Ins 6.20 (6) (d) 2, Wis. Adm. Code.

   Action—Compliance

7. Stock and Mutual Fund Investments—It is recommended that the company comply with the requirements of s. Ins 6.20 (6) (d) 5, Wis. Adm. Code, regarding the investment limitations in any single family of mutual funds.

   Action—Compliance

8. <u>Stock and Mutual Fund Investments</u>—It is recommended that the company report unit investment trusts as required by the annual statement instructions.

   <u>Action</u>—Compliance

9. <u>Net Unpaid Losses</u>—It is again recommended that the company adopt procedures for timely settlement of claims, in compliance with s. Ins 6.11 (3) (a) (2), Wis. Adm. Code.

   <u>Action</u>—Compliance

Current Examination Results

Corporate Records

The minutes of the annual meetings of policyholders and meetings of the board of directors and any committees thereof, were reviewed for the period under examination and also for the subsequent period. The following items were noted:

1. There were no minutes kept for the meetings of the company's board appointed finance and claims committees.
2. Attendance for the last two annual meetings as well as a number of other board of directors meetings was not included with their corresponding minutes.

The first item noted above was included as part of a recommendation in the claims adjusting section of the prior examination report. It is again recommended that the company keep minutes of the claims committee's meetings to provide evidence that it is performing its duty to supervise the adjustment of losses as required by s. 612.13 (4), Wis. Stat. It is further recommended that the minutes be maintained for all committees appointed by the board of directors.

The other exception noted above relates to recording attendance at policyholder and director meetings. It is important that the company document that a quorum is present at all board and annual meetings. It is recommended that the company maintain and record attendance of voting members at all annual meetings in accordance to s. 611.51 (9), Wis. Stat.

Biographical data relating to company officers and directors have not been reported in accordance with the provisions of s. Ins 6.52, Wis. Adm. Code. The company has not filed biographical sketches for four of its nine directors with the Office of the Commissioner of Insurance (OCI). It is recommended that the company report biographical data relating to the officers and directors of the company in accordance with the provisions of s. Ins 6.52, Wis. Adm. Code.

The company has executed formal written agreements with its agents. The contracts include language indicating the agent will represent the company's interests "in good faith."

Fidelity Bond and Other Insurance

The company is afforded coverage under the terms of the following bonds or contracts and has complied with s. Ins 13.05 (6), Wis. Adm. Code, which sets forth the minimum requirements for fidelity bond coverage:

Type of Coverage	Coverage Limits
Fidelity bond:	
Manager and Office Employees	$135,000
Directors (who sign checks)	20,000
Workers Compensation:	
Employee injury	Statutory
Employee liability:	
Bodily injury (per accident)	100,000
Policy limit	500,000
Property coverage:	
Building	Full Replacement
Personal Property	50,000
Personal liability:	
Per occurrence	1,000,000
Medical expenses per person	5,000
Fire legal liability per occurrence	100,000
Products-Completed operations limit	2,000,000
General aggregate policy limit	2,000,000
Professional liability:	
Per claim limit	2,000,000
Aggregate limit	2,000,000
Deductible	5,000
Directors and officers liability:	
Per claim limit	2,000,000
Aggregate limit	2,000,000
Deductible	5,000

Conflict of Interest

In accordance with a directive of the Commissioner of Insurance, each company is required to establish a procedure for the disclosure to its board of directors of any material interest or affiliation on the part of its officers, directors, or key employees which conflicts or is likely to conflict with the official duties of such person. A part of this procedure is the annual completion of a conflict of interest questionnaire by the appropriate persons. The company has adopted such a procedure for disclosing potential conflicts of interest. However, the procedure and the conflict of interest questionnaires are not being completed on an annual basis. It was noted that the directors did not complete conflict of interest statements for the years 1999, 2000, and 2002. In addition, not all of the directors who are independent agents for other insurance companies disclosed this fact on the conflict of interest questionnaire. This information should be included on the questionnaire, as it is possible that a conflict of interest may occur because of the director writing business for other insurers. Similar findings were also found during the prior examination of the company and a recommendation was made. Therefore, it is again recommended that the company require directors to file signed conflict of interest questionnaires with the company on an annual basis and that all potential conflicts are disclosed in compliance with the directive of the commissioner.

Underwriting

The company has a written underwriting guide. The guide covers all the lines of business that the company is presently writing.

The current examination emphasized review of the company's procedures in relation to agents' underwriting of risks, the company's oversight of agent underwriting activity and the company's actions based on the overall underwriting performance. As stated earlier in the report, agents receive a 15% commission for new and renewed risks. As part of the agents' compensation, the company expects that those risks submitted to the company adhere to the standards included in a 200 page underwriting manual given to each of its agents. The company has an inspection program in place to confirm on a sample basis that property risks are being properly underwritten. The company also has procedures in place to ensure that all new farm applications submitted by its agents are inspected and all new applications are reviewed for proper terms, valuation, and category of risk. The examination team found a number of deficiencies and inconsistencies with the underwriting procedures that could be improve on. The following deficiencies were noted:

- Company's written inspection program doesn't include selection criteria for the properties to be re-inspected. It also does not include how many inspections are to be completed in a given month. The examiner was told that the fulltime inspector/adjuster re-inspects 20 properties a month based on the age of the policy and the frequency of claims. However, this was not mentioned in the formal written inspection program.

- A list of inspections performed by the CEO and the fulltime inspector/adjuster is not being maintained. This is noted as a deficiency even though inspection reports are included with their corresponding policy file and the fulltime inspector/adjuster keeps a folder that includes the inspection sheet for every inspection he has made during the year. The company needs an efficient way to identify inspections performed and to summarize and use the inspection data.

- The company has a procedure to inspect all new farm policies. However, it was noted that an inspection form is not used to document the review of the farm properties. Instead, a copy of the policy's declaration page is used as a base document and any comments are to be recorded on it as deemed necessary. The examiners' sample of policy files included eight new farm policies. None of the four declaration pages provided to the examiners contained any comments regarding the inspection performed.

- The company continues to write more new business instead of concentrating on re-inspecting its current book of business. As mentioned earlier, the company's full-time inspector/adjuster re-inspects 20 policies a month. At that pace, assuming that the policy counts remains unchanged from year-end 2003, it will take the company about 15 years to get through its entire book of business.

- The company does not have a report that sorts the inspectors' findings by the agent when material differences are found in the policy. No consequences have been established where an agent is found to regularly insure properties where the inspectors find material differences between the applications submitted and the actual risks insured. The company also does not have a process to track their agents performance, specifically policies that they have non-renewed or new policies that they rejected after the risks were inspected. No consequences have been established where an agent is found to regularly insure properties that do not meet the company's underwriting standards.

The following procedural inconsistencies were noted as part of the underwriting review:

- Examination of the inspection process noted that inspection sheets could not be located for two of the policy files that were reviewed for renewal policy inspections. Further examination of the inspection process noted that copies of new farm-owner policies' declaration pages used to document the review of those properties could not be located for four of the six policy files that were reviewed for new farm-owner policy inspections.

- The agent is required to submit photographs of "major buildings" when a new policy is submitted, which is stated in the company's underwriting manual. However, four of the twenty-one new 2002 policy files reviewed during the examination did not include photographs of the risks being insured. There were three instances where the assessment of the property being insured could not be reasonably determined through the review of the photographs supplied by the agents. Maintaining photographs of insured property will assist management's evaluation of the condition and value of each property, and in the event of a claim.

- The company's farm-application was revised in October of 2002 to reflect its new Blue Ribbon Farm Program. This program allows special discounts to farm owners that meet the Blue Ribbon Farm criteria set by the company. It was noted that the revised farm application was not filed with this office in accordance with s. Ins. 6.05, Wis. Adm. Code.

Additionally, the examiners believe that the company would benefit from establishing a procedure that consistently documents its initial underwriting review and any follow up procedures, when deemed necessary.

It is recommended that the company revise their comprehensive underwriting business plan to include/address the following items and submit the revised plan to the Office of the Commissioner of Insurance (OCI) within 90 days of the adoption of this report:

- Formal written duties for all persons involved in the inspection process,
- Written criteria used to select policies that will be re-inspected,
- Procedures to track the inspections performed and to maintain and utilize the data collected,
- Inspection forms for all policy types, including farm policies,
- A process to monitor and report to the board of directors on the inspection process,
- A plan to devote more resources towards inspections and to re-inspect all its policies within a reasonable amount of time,
- A process to evaluate agent/agency performance, which should include, but is not limited to tracking inspectors' findings by agent when material differences are found between the application submitted and the inspection
- Implementation of formal consequences in situations where an agent/agency is found to regularly insure properties where the inspectors find material differences between the applications submitted and the actual risks insured,
- A process to track their agents' performance specifically relating to the number of policies that the company non-renewed and new policies that they rejected after the risks were inspected, and implement formal written consequences in situations where this is occurring and is becoming problematic,
- A process to ensure that new policy applications and endorsements to policies consistently include proof of the company's underwriting review and approval in their corresponding policy file, and
- A process to ensure that the submission of photographs are received with all applications and inspected risks.

It is also recommended that insurance forms be filed with the Office of the Commissioner of Insurance (OCI) to comply with s. Ins 6.05, Wis. Adm. Code, regarding any changes/amendments to the company's policy forms.

The examiners reviewed a report that includes claims history by policyholder. There were a number of instances where policyholders had claims reported in each year their policy has been in-force and in some cases multiple claims in individual years. Effective October 22, 2003, the company implemented an underwriting guideline which states all policyholders who have incurred three claims in a three-year period will be cancelled, subject to review and possible override by the CEO.

Agency Operations

The company has established Hamburg-Stark Insurance Agency, which was described in the section of this report entitled "Affiliated Companies." Establishing this agency subjected the company to s. Ins 40.15, Wis. Adm. Code, Insurance Holding Company System Regulation. In accordance with s. Ins 40.15, Wis. Adm. Code, the company is required to make certain filings in relation to the agency. This includes the annual registration statement, Form B, the summary registration statement, Form C, and any other filings, which may be required, as the agency increases operations. The company has not made any holding company filings since the first year of operation of the agency. It is recommended that the company, in accordance with s. Ins 40.15, Wis. Adm. Code, properly file all required holding company filings for the agency for all future years.

Agents

The company is required to file with this office all agents that write business for the company, pursuant to s. 628.11, Wis. Stat. The examination found that three agents on the company's list of active agents were not on the company's Registered Agent List maintained by this office, and three agents reported on the Registered Agent List provided by this office were not included on the company's list of active agents. It is recommended that the company submit an application to the Office of the Commissioner of Insurance (OCI) for all the company's agent appointments in accordance with s. 628.11, Wis. Stats., and that the company notify the Office of the Commissioner of Insurance (OCI) of all agents that are terminated and are no longer writing business for the company.

The company's agent contract requires its agents to obtain their own Errors & Omissions (E&O) insurance coverage. However, the company does not require its agents to submit documentation of their E&O coverage. It is recommended that the company obtain and retain a copy of all its agents' current Errors & Omissions (E&O) coverage annually to make sure its agents have adequate E&O coverage in compliance with the agent contract.

The examination noted that the company reviews individual agencies' loss ratios on an annual basis and uses this information to evaluate the agencies' performances. Agencies are then notified of their performance for the year and whether they need to make improvements. However, in the examiners' opinion, the loss ratio the company uses does not accurately evaluate its agencies' performances. Loss ratios are calculated by the company in the following manner:

(Gross Property Losses by Agency) / (Gross Written Premium by Agency) = Loss Ratio per Agency

The above calculation uses a gross premium amount that includes liability premium written, while the loss amount is limited to property losses only. Loss ratios calculated using the above formula are not indicative of the actual total experience of the agencies and are lower than what the actual experience would show. The company could have added liability losses to the property losses or excluded liability gross premium written from the total gross premium written used to make this a more accurate ratio. In any case, it is the examiners' opinion that the loss ratios are misleading and do not represent the true performance of the company's agencies.

A contingent commission incentive program was adopted by the company in April of 2003, which will reward agencies with an additional 1% commission bonus if they have $100,000 or more in premium volume and an overall loss ratio (including liability and property losses) of 50% or less. It is important that the company properly calculate its agencies' loss ratios so that they reflect the agency's true performance. It is recommended that the company calculate loss ratios by the agency that accurately reflects the agency's performance and utilize them to aid in their agency evaluations.

The examination also noted that the company does not take action against agencies that continually report poor loss ratios. Furthermore, as mentioned earlier, information obtained from the inspections that are done is not being compiled in a fashion that allows for the evaluation of the agent writing the policy. Evaluating an agent's performance with the resultant appropriate action contained in the agent contract should aid in identifying and eliminating underwriting problem areas by agent and is necessary when actively managing a company. It is recommended that the company implement a formal policy that appropriately responds to agencies that continually generate poor loss experience.

Claims Adjusting

The company has an adjusting committee consisting of at least three directors as required by s. 612.13 (4), Wis. Stat. The function of this committee is to adjust or supervise the adjustment of losses. The claims committee only meets for those claims exceeding $50,000.00.

The company has hired a full time adjuster/inspector to adjust claims. He is allowed to inspect any claims assigned to him and has claim denial authority up to $15,000. An outside adjuster is used when the full time adjuster is unfamiliar with a claim or there are multiple catastrophe claims that the full time adjuster can not handle by himself. The company's CEO has claim settlement authority up to $50,000.00. Claims exceeding $50,000 to $150,000 are reviewed and settled by the board appointed claims committee. Any claims exceeding $150,000 are reviewed and settled by the board of directors.

Accounts and Records

The examiners' review of the company's records indicated that the company is in compliance with s. Ins 13.05, Wis. Adm. Code, which sets forth the minimum standards for the handling of cash and recording of cash transactions by town mutual insurance companies. The examiners noted the following:

1. A proper policy register is maintained.
2. A proper cash receipts journal is maintained.
3. A proper cash disbursements journal is maintained.
4. A proper general journal is maintained.
5. A proper general ledger is maintained.

An extensive review was made of income and disbursement items. Cash receipts were traced from source records and the proper recording and eventual deposit thereof ascertained. Negotiated checks issued during the period under examination were reviewed, test checked for proper endorsement, and traced to cash records. The verification of assets and determination of liabilities were made as of December 31, 2002.

The company is audited annually by an outside public accounting firm.

Unclaimed Funds

EDP Environment

Company personnel were interviewed with respect to the company's Electronic Data Processing environment. Access to the computers is limited to people authorized to use the computers. Company personnel back up the computers daily and the backed-up data is kept offsite.

A manual which describes how to use the company's software and outlines the steps to complete specific tasks assists in the continuity of operations for seldom-used applications, training, or when staff turnover occurs. The company has manuals documenting the use of its software.

Disaster Recovery Plan

A disaster recovery plan identifies steps to be performed in case the company loses a key employee, is not able to access its computer, information on its computer was lost, or the office building was destroyed, to name a few contingencies. The company has not developed a written disaster recovery plan. This was a finding in the prior examination of the company. Therefore, it is again recommended that the company develop a written disaster recovery plan.

Invested Assets

Section 610.23, Wis. Stat., requires insurers to hold all investments and deposits of its funds in its own name except that:

(1) Securities kept under a custodial agreement or trust arrangement with a bank or banking and trust company may be issued in the name of a nominee of the bank or banking and trust company; and

(2) Any insurer may acquire and hold securities in bearer form.

For securities not held under a custodial agreement or trust arrangement with a bank or banking and trust company, s. Ins 13.05 (4), Wis. Adm. Code, requires that:

> Non-negotiable evidences of company investments such as registered bonds, certificates of deposits, notes, etc., shall be maintained in a safe or vault with adequate safety controls or in a safety deposit box in a bank. Negotiable evidences of company investments shall be maintained in a safety deposit box in a bank. Access to a company safety deposit box containing negotiable securities shall require the presence and signature of at least 2 officers, directors or employees of the company.

The company is in compliance with these requirements.

According to the General Interrogatories to the 2002 Annual Statement, the company has had an investment plan adopted by the board of directors since 1997. However, the company could not supply the examiner with their investment policy. Therefore, the examiner was unable to determine if the company had a written investment plan approved by the board of directors in accordance with s. Ins 6.20(6) (h), Wis. Adm. Code. It is recommended that the company establish a formal written plan for the company's investments in accordance with s. Ins 6.20(6) (h), Wis. Adm. Code.

Investment Rule Compliance

The investment rules for town mutuals allows a company to invest in common stocks, common stock mutual funds, and other higher risk investments (referred to as "Type 2" investments) provided that the town mutual has a sufficient amount of lower risk investments (referred to as "Type 1" investment). A town mutual may invest in Type 2 securities only if it already has sufficient Type 1 investments. Type 1 investments must equal or exceed the greater of items 1, 2, or 3.

1.	Liabilities plus $300,000	$1,817,667
2.	Liabilities plus 33% of gross premiums written	2,291,462
3.	Liabilities plus 50% of net premiums written	2,472,334
4.	Amount required (greater of 1, 2, or 3)	2,472,334
5.	Amount of Type 1 investments as of 12/31/2002	1,401,718
6.	Excess or (deficiency)	$(1,070,616)

The company does not have sufficient Type 1 investments.

The company was granted an exception on September 12, 2002, by this office to invest in GNMA and FNMA Pass-Through Securities with final maturities greater than fifteen years without regard to the sufficiency of the company's Type 1 investments required by s. Ins 6.20(6) (c), Wis. Adm. Code. These investments are limited to 10% of invested asset. In April, 1997, the company was approved to hold their real estate property and three issues of stock that they owned prior to year-end 1996. There were no other investment exceptions granted.

ASSETS

Cash and Invested Cash **$439,138**

The above asset is comprised of the following types of cash items:

Cash in company's office	$ 100
Cash deposited in banks-checking accounts	89,276
Cash deposited in banks at interest	349,762
Total	$439,138

Cash in the company's office at year-end represents the company's petty cash fund. A physical count was made by the examiners during the course of the examination and the balance reconciled to year-end.

Cash deposited in banks subject to the company's check and withdrawal consists of one account maintained in a local bank. Verification of checking account balances was made by obtaining confirmations directly from the depository and reconciling the amounts shown thereon to company records.

Cash deposited in banks represents the aggregate of five deposits in four depositories. Deposits were verified by direct correspondence with the respective depositories and by an actual count and inspection of certificates and/or passbooks. Interest received during the year 2002 totaled $10,009 and was verified to company cash records. Rates of interest earned on cash deposits ranged from 3.25% to 6.7%. Accrued interest on cash deposits totaled $2,693 at year-end.

Book Value of Bonds **$902,950**

The above asset consists of the aggregate book value of bonds held by the company as of December 31, 2002. Bonds owned by the company are held under a safekeeping agreement with a bank custodian.

Bonds were confirmed to the year-end bank custodial statement. Bond purchases and sales for the period under examination were checked to brokers' invoices and advices. The company's investment in bonds was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers. However, the actual cost of one of the company’s bond holdings did not accurately reflect what was reported as the purchase price on the year-end custodial statement. The examiner discussed the discrepancy with the company's CPA and was told that the cost to acquire this investment was not reported accurately in the 2002 Annual Statement. Therefore, it is recommended that the company report bond investments in accordance with the Town Mutual Annual Statement Instructions.

Interest received during 2002 on bonds amounted to $44,881 and was traced to cash receipts records. Accrued interest of $12,584 at December 31, 2002 was checked and allowed as a nonledger asset.

Stocks and Mutual Fund Investments **$417,671**

The above asset consists of the aggregate market value of stocks and mutual funds held by the company as of December 31, 2002. Stocks owned by the company are maintained in a safety deposit box at its bank.

Stock certificates were physically examined by the examiners. Stock and money market fund purchases and sales for the period under examination were checked to brokers' invoices and advices. The company's investment in stocks and money market funds was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers.

Dividends received during 2002 on stocks and money market funds amounted to $2,303 and were traced to cash receipts records. There were no accrued dividends at December 31, 2002, from stocks or money market funds held by the company.

Book Value of Real Estate **$98,165**

The above amount represents the company's investment in real estate as of December 31, 2002. The company's real estate holdings consisted of the company's home office building.

The required documents supporting the validity of this investment were reviewed and were in order. Adequate hazard insurance was carried on the real estate and contents as noted under the caption, "Fidelity Bond and Other Insurance." The company's investment in real estate and related items was in conformance with the Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers. Real estate depreciation is calculated using the straight-line method.

Agents' Balances or Uncollected Premiums **$468,500**

The above ledger asset represents the amounts due from agents or policyholders which are not in excess of 90 days past due at year-end. A review of individual agent's accounts verified the accuracy of this asset.

Investment Income Due and Accrued **$15,277**

Interest due and accrued on the various assets of the company as of December 31, 2002, consists of the following:

Asset	**Interest Accrued**
Cash at Interest	$ 2,693
Bonds	12,584
Total:	$ 15,277

To verify the above balance, the amounts were recalculated using outside source documentation as well as reviewing subsequent receipt of these amounts and tracing them to the cash receipts records.

Reinsurance Recoverable on Paid Losses **$24,033**

The above asset represents recoveries due to the company from reinsurance on losses which were paid on or prior to December 31, 2002. A review of year-end accountings with the reinsurer verified the above asset.

Electronic Data Processing Equipment **$12,908**

This asset consists of computer hardware owned by the company as of December 31, 2002. The company properly non-admitted its non-operating software of $21,979.00. The most recent purchases were traced to invoices and the company’s cash disbursement records.

Equipment, Furniture, and Supplies **$2,107**

This asset consists of $2,107 of furniture and fixtures owned by the company as of December 31, 2002. In accordance with annual statement requirements, this amount has been deducted as an asset not admitted.

LIABILITIES AND SURPLUS

Net Unpaid Losses **$190,233**

This liability represents losses incurred on or prior to December 31, 2002, and remaining unpaid as of that date. The examiners' development of unpaid losses is compared with the amount estimated by the company in the following schedule. Differences are reflected in the section of this report captioned "Reconciliation of Policyholders' Surplus."

	Company Estimate	Examiners' Development	Difference
Incurred But Unpaid Losses	$322,577	$193,257	$129,320
Less:			
Reinsurance Recoverable on Unpaid Losses	132,344	31,867	100,477
Net Unpaid Losses	$190,233	$161,390	$ 28,843

The examiners developed this liability by totaling actual loss payments made through the development period on those losses incurred on or prior to December 31, 2002. To the actual paid loss figures was added an estimated amount for those in 2002 and prior losses remaining unpaid at the examination date. The above positive difference indicates redundant reserves and was within an acceptable range. Given the inherent variability of these estimates, the examiners made no adjustments to surplus.

The examiners' review of claim files included open claims, paid claims, claims closed without payment, and all claims which were denied during the examination period. The review indicated that claims are investigated and evaluated properly and that payments are made promptly and in accordance with policy provisions upon the submission of a proper proof of loss. In addition, the review of claims handling procedures and files revealed the following:

1. A proper loss register is maintained.
2. Claim files contained sufficient investigatory data and documentation to verify settlement payments or reserve estimates.
3. Proofs of loss were properly signed when applicable.

The loss register is maintained in accordance with s. Ins 13.05, Wis. Adm. Code.

Unpaid Loss Adjustment Expenses **$15,297**

The original liability of $4,000 represents the company's estimate of amounts necessary to settle losses, which were incurred prior to December 31, 2002, but which remained unpaid as of year-end. The examiners tested the adequacy of the balance by calculating a paid LAE to paid loss ratio and applying it to the unpaid loss balance, which resulted in an unpaid LAE balance of $15,297.00. The company established this liability judgmentally by multiplying the company's gross unpaid property losses for year-end by 5%. The company represented that the percentage used to calculate the unpaid LAE balance was increased from 2% from the prior year due to the company recently incurring more losses. However, this method is not adequate compared to the paid LAE to paid loss method, which directly calculates the ratio of paid LAE to paid losses and applies that ratio to unpaid losses. The difference of $11,297 noted above is presented as an adjustment to surplus in the Reconciliation of Policyholders' Surplus section of this report. It is recommended that the company use the paid-to-paid methodology or develop its own calculation to establish an adequate reserve for loss adjustment expenses.

Unearned Premiums **$1,033,073**

This liability represents the reserve established for unearned premiums in compliance with s. Ins 13.08 (3), Wis. Adm. Code. This reserve was established using a daily pro rata methodology.

Reinsurance Payable **$141,374**

This liability consists of amounts due to the company's reinsurer as of December 31, 2002, relating to transactions which occurred on or prior to that date. Amounts listed below are the reinsurer's portion of premiums collected in December of 2002 by contract type, the year-end adjustment for the company's written premium results, and the reinsurer's portion of deferred premiums at year-end.

Contract Description	Amount
Class A, Liability	$ 14,200
Class B, First Surplus	18,429
Class C-1, Excess of Loss	3,625
Class C-2, Excess of Loss	1,800
Class D/E, Stop Loss	14,875

Year-end Adjustment for	
Excess of Loss & Stop Loss Premiums	32,319
Deferred Reinsurance Payable	56,126
Total:	$141,374

Subsequent cash disbursements and reinsurance accountings verified the amount of this liability.

Fire Department Dues Payable **$3,928**

This liability represents the fire department dues payable as of December 31, 2002. The examiners reviewed the company's fire department dues calculation and found this liability to be correctly calculated. The actual amount paid was verified to the cash disbursement records.

Commissions Payable **$104,843**

This liability represents commissions earned by the company's agents that were unpaid as of December 31, 2002. Agents are paid when money for the related premium is received from the policyholder. The examination determined this liability to be adequately stated.

Accounts Payable **$5,571**

This liability represents amounts for expenses incurred in 2002, but not paid as of year-end. The company reported a year-end accounts payable balance of $3,449. A search for unrecorded liabilities was performed to verify the accounts payable balance, and found five invoices equaling $5,571 that were due for 2002 expenses. An adjustment of $2,122 was made to increase the accounts payable balance and is reflected in the Reconciliation of Policyholders' Surplus section of this report. It is recommended that the company properly accrue all expenses incurred in the report year, but unpaid as of year-end in accordance with the <u>Town Mutual Annual Statement Instructions.</u>

Accrued Property Taxes **$4,179**

This liability represents the amount of 2002 property taxes that are unpaid as of December 31, 2002. The balance includes taxes on both real property and personal property. The accrued amount was traced to 2002 property tax documents and a subsequent payment to verify the balance.

Premiums Paid in Advance **$32,588**

This liability represents premiums paid on or before December 31, 2002, related to policies with effective dates subsequent to year-end. The examiner traced the balance to a detailed inventory of advance premiums, and verified a sample of advance premium by review of the policy files and cash receipts records.

V. CONCLUSION

The examination of the Hamburg-Stark Mutual Insurance Company resulted in 16 recommendations, three of these are repeated from the prior examination, and two adjustments to policyholder's surplus. The adjustments resulted in an aggregate decrease to surplus of $13,419.00. The recommendations relate to a variety of different topics ranging from accounting practices and the reporting of balances on the various schedules in the company's annual statement to corporate records and the electronic data processing environment. The comments and recommendations are summarized in the subsequent section.

The company has consistently experienced underwriting losses. During the four-year period under examination, the company reported total underwriting losses of $626, 978.00. A recommendation was made concerning the development of a comprehensive underwriting business plan to address many deficiencies and inconsistencies the company has in key underwriting areas.

Another significant portion of the recommendations relate to the manner in which the company manages its agents and agencies. Agent appointments and terminations were not filed with this office. Agents and agencies were being critically evaluated based on their performance for the year. However, there were no consequences when an agent or agency performed poorly. It was also noted that the loss ratio information used to evaluate the agents was misleading. All of the above suggests that the company has a lack of control over its agents.

The company's surplus per examination of $847,556 represents a 31% decrease over the past four years. The company reported 2002 gross premiums written of $2,344,833 a 13% increase from the prior year. The company experienced underwriting losses in nine consecutive years prior to 2002. The company's loss ratio for the past five years averaged 80% and its expense ratio averaged 40%. Ten-year trend analysis shows that the company has increased premium writings while surplus has been declining dramatically. As of year-end 2002, the company's net premium written to surplus ratio increased to 222%, which is up from the prior year's ratio of 137%. The current premium to surplus ratio is five times greater than the town mutual industry average of 43% and at a level where management should be concerned about the risk it represents to the company’s financial health.

It should be noted that management has taken steps to increase rates, which partially explains the higher premium volume noted above, and is implementing certain underwriting changes. Subsequent to the examination fieldwork the board of directors approved an underwriting guideline that would cancel any policyholders that incur three claims within a three year period, subject to review and possible override by the CEO.

VI. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 19 - Corporate Records—It is again recommended that the company keep minutes of the claims committee's meetings to provide evidence that it is performing its duty to supervise the adjustment of losses as required by s. 612.13 (4), Wis. Stat. It is further recommended that the minutes be maintained for all committees of the board of directors.

2. Page 19 - Corporate Records—It is recommended that the company maintain and record attendance of voting members at all annual meetings in accordance to s. 611.51 (9), Wis. Stat.

3. Page 19 - Corporate Records—It is recommended that the company report biographical data relating to the officers and directors of the company in accordance with the provisions of s. Ins 6.52, Wis. Adm. Code.

4. Page 21 - Conflict of Interest—It is again recommended that the company require directors to file signed conflict of interest questionnaires with the company on an annual basis and that all potential conflicts are disclosed in compliance with the directive of the commissioner.

5. Page 23 - Underwriting— It is recommended that the company revise their comprehensive underwriting business plan to include/address the following items and submit the revised plan to the Office of the Commissioner of Insurance (OCI) within 90 days of the adoption of this report:

    - Formal written duties for all persons involved in the inspection process,
    - Written criteria used to select policies that will be re-inspected,
    - Procedures to track the inspections performed and to maintain and utilize the data collected,
    - Inspection forms for all policy types, including farm policies,
    - A process to monitor and report to the board of directors on the inspection process,
    - A plan to devote more resources towards inspections and to re-inspect all its policies within a reasonable amount of time,
    - A process to evaluate agent/agency performance, which should include, but is not limited to tracking inspectors' findings by agent when material differences are found between the application submitted and the inspection,
    - Implementation of formal consequences in situations where an agent/agency is found to regularly insure properties where the inspectors find material differences between the applications submitted and the actual risks insured,
    - A process to track their agents' performance specifically relating to the number of policies that the company non-renewed and new policies that they rejected after the risks were inspected, and implement formal written consequences in situations where this is occurring and is becoming problematic,
    - A process to ensure that new policy applications and endorsements to polices consistently include proof of the company's underwriting review and approval in their corresponding policy file, and
    - A process to ensure that the submission of photographs are received with all applications and inspected risks.

6. Page 23 - Underwriting—It is recommended that insurance forms are filed with the Office of the Commissioner of Insurance (OCI) to comply with s. Ins 6.05, Wis. Adm. Code, regarding any changes/amendments to the company's policy forms.

7. Page 24 - Agency Operations—It is recommended that the company, in accordance with s. Ins 40.15, Wis. Adm. Code, properly file all required holding company filings for the agency for all future years.

8. Page 24 - Agents—It is recommended that the company submit an application to the Office of the Commissioner of Insurance (OCI) for all the company's agent appointments in accordance with s. 628.11, Wis. Stats., and that the company notify the Office of the Commissioner of Insurance (OCI) of all agents that are terminated and are no longer writing business.

9. Page 24 - Agents—it is recommended that the company obtain and retain a copy of all their agents' current Errors & Omissions (E&O) coverage annually to make sure their agents have adequate E&O coverage in compliance with their agent contract.

10. Page 25 - Agents—It is recommended that the company calculate loss ratios by agency that accurately reflects the agency's performance and utilize them to aid in their agency evaluations.

11. Page 25 - Agents—It is recommended that the company implement a formal policy that appropriately responds to agencies that continually generate poor loss ratios.

12. Page 27 - Disaster Recovery Plan—It is again recommended that the company develop a written disaster recovery plan.

13. Page 28 - Invested Assets—It is recommended that the company establish a formal written plan for the company's investments in accordance with s. Ins 6.20 (6) (h), Wis. Adm. Code.

14. Page 30 - Book Value of Bonds—It is recommended that the company report bond investments in accordance with the Town Mutual Annual Statement Instructions.

15. Page 34 - Unpaid Loss Adjustment Expenses—It is recommended that the company use the paid-to-paid methodology or develop its own calculation to establish an adequate reserve for loss adjustment expenses.

16. Page 35 - Accounts Payable—It is recommended that the company properly accrue all expenses incurred in the report year, but unpaid as of year-end in accordance with the Town Mutual Annual Statement Instructions.

VII. ACKNOWLEDGMENT

The courteous cooperation extended to the examiners by the company's personnel is hereby acknowledged.

In addition to the undersigned, DuWayne Kottwitz and Sheur Yang of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

Respectfully submitted,

John Litweiler
Examiner-in-Charge